17 June 2022

Re: Fiduciary Duty of State Pension Fund Trustees to Divest Holdings in the Fossil Fuel Industry

To Members of the Committee on Public Employment and Retirement & Committee on Judiciary:

We write to request that Committee members support The Fossil Fuel Divestment Act (SB 1173), requiring California state pension funds CalPERS and CalSTRS to divest from fossil fuels by July 2027. We believe such divestment is called for by the pension trustees' fiduciary duties, and that the Act is written to provide sufficient flexibility for pension funds to fulfill their fiduciary duties.

The recently released Intergovernmental Panel on Climate Change (IPCC) report on *Impacts, Adaptation and Vulnerability*[1] — the second part of the Sixth Assessment Report — confirms that irreversible damage is already occurring to natural ecosystems, communities, and human rights, and will accelerate to an unprecedented scale and pace if global temperature rise surpasses 1.5°C. The IPCC report on *Mitigation of Climate Change*[2] — the third part of the Sixth Assessment Report — further affirms that the accelerated phaseout of all fossil fuels must be the centerpiece of a global climate mitigation strategy. The IPCC notes that ambitious pathways limiting global atmospheric temperature rise to 1.5°C could require a 100% decline in the use of coal, and 90% declines in the use of oil and gas, by 2050.[3] In response to these findings, UN Secretary General António Guterres has clearly stated that "our continued reliance on fossil fuels makes the global economy and energy security vulnerable to geopolitical shocks and crises," "fossil fuels are a dead end," and "[i]nvesting in new fossil fuels infrastructure is moral and economic madness."[4]

Given these stark facts, we believe that the significant exposure of your state's pension funds to fossil fuel assets may be in breach of their trustees' fiduciary obligations, including obligations under state statute and the California Constitution.[5] In particular, we note possible violations of the California Constitution's primary duty rule, to serve "solely in the interest of, and for the exclusive purposes of providing benefits to" members and beneficiaries, as well as the prudent expert rule;[6] and the common law fiduciary duties of prudence and impartiality, by privileging the interests of current retirees over those of future retirees. In order to ensure your state's pension funds provide sustainable, long-term returns for their beneficiaries, we urge you to compel the funds to disclose all fossil fuel holdings and adopt a climate-risk management plan that both immediately cuts investments in fossil fuels and ensures that all other assets in their portfolios are aligned with the 1.5°C limit in the Paris Agreement.

Climate Change is a Systemic Risk and a Threat to Financial Stability

[1] Intergovernmental Panel on Climate Change (IPCC), *Climate Change 2022: Impacts, Adaptation and Vulnerability* (Working Group II contribution to the Sixth Assessment Report)(February 2022)
[2] IPCC, *Climate Change 2022: Mitigation of Climate Change* (Working Group III contribution to the Sixth Assessment Report) (April 2022)
[3] *Jim Skea et al.,* Working Group III *Summary for Policymakers*, at C.3.2, SPM-32, *in* IPCC, Climate Change 2022: Mitigation of Climate Change [hereinafter WGIII AR6 SPM]
[4] *António Guterres (UN Secretary-General) to the press conference launch of IPCC report* (February 28 2022), *Secretary-General Warns of Climate Emergency, Calling Intergovernmental Panel's Report 'a File of Shame', While Saying Leaders 'Are Lying', Fuelling Flames* (April 4 2022)
[5] Cal. Const. art. XVI § 17 and CA Prob Code § 16047
[6] Cal. Const., art. XVI, § 17(b) & (c)

Banks,[7] investors,[8] and regulators[9] alike have widely accepted that climate change poses a systemic risk to the financial system, an assessment strongly backed by empirical evidence. Through physical and transition risks, climate change has the potential to destabilize the normal functioning of the financial system and lead to serious negative consequences for the real economy. A London School of Economics study projected that unaddressed climate change resulting in warming of 2.5ºC by 2100 could reduce the value of global financial assets by as much as $24 trillion.[10] Under current climate policies, the UN estimates warming of 3.2ºC by 2100.[11] The Director of the IMF's monetary and capital markets department has warned that the climate crisis could "absolutely" ignite a financial crisis.[12] In the US, a 2021 report by the U.S. Commodity Futures Trading Commission found that climate-related risks could result in systemic shocks to the US financial system,[13] and a subsequent report on climate-related financial risks published by the Financial Stability Oversight Council is premised on the assumption that "climate change is an emerging threat to the financial stability of the United States."[14] Federal Reserve Chairman Jerome Powell has acknowledged that "there is no doubt that climate change poses profound challenges for the global economy and certainly the financial system."[15]

In light of this, financial regulators in the US and internationally are in the midst of establishing rules and regulations to enhance climate-risk management and disclosure by their regulated entities. Examples of this include the recently announced SEC climate change disclosure rules,[16] the Office of the Comptroller of the Currency's development of principles for climate-related financial risk management by banks,[17] and the Department of Labor's request for information to solicit input on the future work of the Employee Benefits Security Administration (EBSA) relating to retirement savings and climate-related financial risk.[18]

Continued Investment in Fossil Fuels is High Risk

Fossil fuels are the primary driver of the climate crisis, with their production and use generating the large majority of global emissions.[19] Amidst a consensus that emissions must be halved by 2030 in order to stay within the 1.5ºC Paris Agreement goal, fossil fuels are particularly exposed to several forms of

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[7] KPMG, *Climate risk is financial risk - for banks, it's a board-level issue* (April 7, 2021)
[8] CERES, *Addressing Climate as a Systemic Risk: A Call to Action for US Financial Regulators* (June 2020)
[9] Network for Greening the Financial System (NGFS), *A call for Action: Climate Change as a Source of Financial Risk* (April 2019)
[10] The Grantham Research Institute on Climate Change, London School of Economics and Political Science, *Climate Value at Risk' of global financial assets* (April 2016)
[11] *See* WGIII AR6 SPM, *supra* note 3, at p21
[12] CNN Business, *Climate change could ignite a financial crisis, IMF official says* (June 3, 2021)
[13] Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission, *Managing Climate Risk in the US Financial System* (September 9, 2021)
[14] Financial Stability Oversight Council, *Report on Climate-related Financial Risk 2021*
[15] CNN Business, *Fed chair Powell warns of 'profound challenges' posed by climate change* (June 4, 2021)
[16] US Securities and Exchange Commission, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (March 21, 2022)
[17] Office of the Comptroller of the Currency, *Risk Management: Principles for Climate-Related Financial Risk Management for Large Banks: Request for Feedback* (December 16, 2021)
[18] US Department of Labor, Employee Benefits Security Administration, *Request for Information Possible Agency Actions to Protect Life Savings and Pensions from Threats of Climate-Related Financial Risk* (February 14, 2022)
[19] *See* WGIII AR6 SPM, *supra* note 3, at Figure SPM.1, SPM-6.

transition risk, arising from regulatory changes required to achieve the Paris Agreement goals, as well as market dynamics favoring clean energy and climate litigation. For example, continued regulatory actions to phase out gasoline-powered cars, to support the deployment of renewable energy, and to decarbonize industrial processes, among others, directly threaten the long-term outlook of the fossil fuel sector. Further, this risk is neither slow nor predictable. As outlined by the UN Principles for Responsible Investment,[20] a rapid and significant policy response to climate change could quickly and dramatically devalue—or strand—fossil fuel assets, presenting a severe potential downside risk to investors.[21] The recent IPCC report has affirmed this assessment, noting with high confidence that "limiting global warming to 2°C or below will leave a substantial amount of fossil fuels unburned and could strand considerable fossil fuel infrastructure." The report estimates that "the combined global discounted value of the unburned fossil fuels and stranded fossil fuel infrastructure has been projected to be around 1–4 trillion dollars from 2015 to 2050 to limit global warming to approximately 2°C, and it will be higher if global warming is limited to approximately 1.5°C."[22]

Amplifying these factors is fossil fuel companies' fundamental unwillingness to meaningfully participate in the low-carbon transition. In recent years, the sector has spent mere pennies on the dollar on renewable research and deployment, while devoting the vast majority of its budget to continued fossil fuel extraction.[23] Despite recent pronouncements of aligning with a goal of net zero emissions by 2050, no major fossil fuel company today is aligned with the goals of the Paris Agreement,[24] and substantially all industry players both facilitate the spread of misinformation[25] and lobby against climate policies.[26] Such activities not only leave the industry structurally unprepared for the low-carbon transition, but also create accruing liability risks from climate litigation — both domestically and internationally — which further threaten enormous and unprecedented losses.[27] The threat of climate litigation is increasingly extending beyond fossil fuel companies to include pension funds and other financial institutions.[28] Meanwhile, the IPCC has recognized climate-related litigation as affecting the outcome and ambition of climate governance.[29]

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[20] *See Preparing investors for the Inevitable Policy Response to climate change*, UN Principles for Responsible Investment, https://www.unpri.org/sustainability-issues/climate-change/inevitable-policy-response

[21] Carbon Tracker Initiative, *Balancing the Budget* (November 1, 2019) ("Companies that continue to sanction higher-cost projects which do not fit with a lower demand scenario risk destroying significant shareholder value through the creation of stranded assets, as well as contributing to the failure to achieve climate goals.")

[22] *See* WGIII AR6 SPM, *supra* note 3, at p36

[23] Ron Bousso, *Big Oil spent 1 percent on green energy in 2018*, Reuters (November 11, 2018); *see also Li M, Trencher G, Asuka J, The clean energy claims of BP, Chevron, ExxonMobil and Shell: A mismatch between discourse, actions and investments. PLoS ONE 17(2): e0263596. (February 16 2022);* Sabrina Valle & Ross Kerber, *Investors on board of U.S. oil majors dismiss wind and solar projects*, Reuters (October 27, 2021)

[24] *See* Anjil Raval, *Big fossil fuel groups all failing climate goals, study shows*, Financial Times (October 6 2020); *Discussion Paper: Big Oil Reality Check*, Oil Change International (September 3, 2020).

[25] *See, e.g.*, Geoffrey Supran and Naomi Oreskes, *Assessing ExxonMobil's climate change communications* (1977–2014), 12(8) Envtl. Res. Letters (August 2017). *See also*, e.g. ClientEarth, *The Greenwashing Files*, and CIEL, *Smoke and Fumes*

[26] *Corporate Climate Policy Footprint*, InfluenceMap (November 2021)

[27] See Subodh Mishra, Institutional Shareholder Services, *The Rise of Climate Litigation* in Harvard Law School Forum on Corporate Governance, March 3, 2022; Jessica Bateman, *Why Climate Lawsuits Are Surging*, BBC (December 7, 2021); 2° Investing Initiative & MinterEllison, *The Carbon Boomerang: Litigation Risk as a Driver and Consequence of the Energy Transition* (2017); Stanley Reed & Claire Moses, *A Dutch court rules that Shell must step up its climate change efforts*, N.Y. Times (May 26, 2021); Isabella Kaminskion, Legal Action Against Shell Board Previews Wave of Lawsuits Against Company Directors, DeSmog (March 15, 2022)

[28] See. e.g. *Activists behind Shell climate verdict target 30 multinationals*, Reuters (January 13, 2022); *Statement from Australia's Retail Employees Superannuation Trust (Rest)* (November 2, 2020) (to settle litigation brought by a beneficiary over its handling of climate change risk)

[29] *See* WGIII AR6 SPM, *supra* note 3, at p59

Aside from the financial risk, continued investments in fossil fuels significantly endanger the wellbeing of pension beneficiaries due to its climate impacts, by negatively affecting critical food supply, water availability, and infrastructure. In 2021, alone, the U.S. experienced 20 separate billion-dollar weather and climate disasters, with a price tag of $145 billion, coming in second place for the most disasters in a calendar year after 2020.[30] A retirement income is meaningless to beneficiaries if their environment becomes increasingly uninhabitable.

Pension Funds have a Fiduciary Duty to Divest from Fossil Fuels

For this reason, institutions representing an unprecedented total of over $40 trillion worth of assets have now committed to some form of fossil fuel divestment, a figure that's higher than the annual GDP of the United States and China combined.[31] At the state level, last year, the state of Maine became the first state in the country to commit to fossil fuel divestment through legislation. The legislation passed in June directed the Maine Public Employee Retirement System to divest $1.3 billion from fossil fuels within five years and directed the state treasury to do the same with other state funds.[32] Fossil fuel divestment has also been demonstrated in New York City,[33] New York State,[34] Minnesota,[35] Washington DC,[36] and the city of Baltimore,[37] as well as internationally by some of the largest pension funds.[38]

Pension fund decision-makers have a fiduciary duty to consider risk when making decisions regarding their funds and investments. The IPCC acknowledges that "Finance for new fossil fuel-related assets lock in future GHG emissions that may be inconsistent with remaining carbon budgets and…with emission pathways to reach the Paris Agreement goals."[39] Given the growing financial risk associated with fossil fuel investments and the clarity of climate science indicating the necessity to rapidly shift away from fossil fuels in order to avoid surpassing 1.5ºC of warming, and avoiding further catastrophic harm, it could not be any clearer that pension funds must divest from fossil fuels now. In particular, we note the following fiduciary duties as particularly relevant here:

1) **Duty of Prudence**

The trustees of your state pension funds are bound by the fiduciary duty of prudence to "invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise

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[30] NOAA, *2021 U.S. billion-dollar weather and climate disasters in historical context* (January 24, 2022)
[31] Global Fossil Fuel Commitments Database, Divestmentdatabase.org (Accessed April 6 2022). *See also* Stand.Earth et al, *Invest Divest 2021: A Decade of Progress Towards a Just Climate Future* (October 2021)
[32] *New Maine law marks U.S. first on fossil fuel divestment*, Reuters (June 17, 2021)
[33] Office of the City of New York, *Mayor de Blasio, Comptroller Stringer, and Trustees Announce Estimated $4 Billion Divestment from Fossil Fuels* (January 25, 2021)
[34] *New York's $226 Billion Pension Fund Is Dropping Fossil Fuel Stocks*, The New York Times (December 9, 2020); Press Release, Office of the New York State Comptroller, *New York State Pension Fund Sets 2040 Net Zero Carbon Emissions Target* (December 9, 2020)
[35] *Minnesota State Board votes to divest from thermal coal firms*, Pensions & Investments (June 3, 2020)
[36] *Washington D.C. Pension Fund Announces Full Fossil Fuel Divestment*, Inside Climate News (June 6, 2016)
[37] *City Councilman: Baltimore puts its money where its mouth is, passing bill to divest pension funds from fossil fuels*, Commentary, The Baltimore Sun (July 26, 2021)
[38] See, e.g. *One of world's biggest pension funds to stop investing in fossil fuels*, The Guardian (October 26, 2021)
[39] Silvia Kreibiehl, Tae Yong Jung et al, Investment and Finance, 15.3.3 at 15-27 *in* IPCC, Climate Change 2022: Mitigation of Climate Change

reasonable care, skill, and caution."[40] The prudent investor standard, as applied to pensions, prioritizes protecting the long term value of the fund.[41] Because of the multiple converging financial risks facing the fossil fuel sector, investments in fossil fuels are incompatible with such a mandate.[42]

Pension fund fiduciaries are required to avoid unnecessary, unmanageable risks. The transition risks presented by fossil fuel investments are both inevitable and unpredictable with respect to timing–practically the very definition of unmanageable. The inherent volatility of fossil fuel investments and the linkages of fossil fuels to political instability has been most recently illustrated by the Russian invasion of Ukraine - where oil and gas exports make up more than a third of Russia's budget and therefore are helping to fuel the brutal and illegal war in Ukraine. It has been reported that BlackRock, the second largest investor in the Russian fossil fuel industry,[43] lost $17 billion in funds due to Russian exposure at the time of the invasion.[44] Such abrupt shifts in investment flows and the consequent stranding of capital assets is not merely a hypothetical risk, but one to which the fossil economy is prone.

Far from causing losses to the portfolio, evidence suggests divestment from fossil fuels and elimination of exposure to this sort of systemic risk would have significant upsides. Independent research has found that CalPERS and CalSTRS would have gained an additional $19+ billion in revenue by 2019 if they had divested from fossil fuels in 2009,[45] and that the costs of divestment estimated by CalPERS and CalSTRS are significantly exaggerated.[46]

Pension fund trustees may argue that retaining the fund's fossil fuel investments keeps its portfolio diversified, but this argument is without merit. Although pension fund fiduciaries also have a duty to diversify, that duty is not blind or absolute. Rather than presenting an ironclad requirement to invest in every sector, the duty to diversify is a distillation of the requirement to reduce risk in the portfolio. In recent years, the fossil fuel industry has underperformed the market, and Exxon's removal from the Dow is a clear indicator of the changes underway in the energy sector, in favor of clean energy.[47] Currently the S&P 500 index contains 2.7% in fossil fuel holdings, down from its historic high in the 1980s of over 25%.[48] For this reason, divestment of fossil fuel holdings would still leave the fund with an amply diversified portfolio while reducing a variety of unacceptable risks.[49]

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[40] Uniform Prudent Investor Act Sec. 2(a) (codified in California law at Cal. Prob. Code § 16047). *See also* Cal. Const., art. XVI, § 17 (c)

[41] *See, e.g.*, The Woodward School for Girls, Inc. v. City of Quincy, 469 Mass. 151, 163-65 (Mass. 2014)

[42] [4]*See, e.g.*, Bevis Longstreth and Connor Chung, *Finance Must Combat Climate Change – or Else*, Project Syndicate (Nov. 9, 2021) ("In other words, the fossil-fuel industry's business model is now so misaligned with scientific and financial reality that betting on these companies… is not just misguided. It is negligently wrong as a matter of law.")

[43] The Sunrise Project, *THE PUTIN100* (accessed April 17, 2022)

[44] Fortune, *BlackRock funds just lost $17 billion due to Russian exposure. That's just the tip of the iceberg, as Western banks are owed $121 billion by Russian entities* (March 11, 2022)

[45] Fossil Free California, *CA/CO Pension Funds Lost Billions on Fossil Fuels* (November 11, 2019)

[46] Fossil Free California, *Hyperbole in the Hearings: Pension Funds Exaggerate the Cost of Divestment* (May 9, 2022)

[47] *Here's what Exxon's removal from the Dow says about the energy sector*, Market Watch (August 25, 2020). *See also* David Carlin, *The Case For Fossil Fuel Divestment*, Forbes (February 20 2021)

[48] *See S&P 500*, S&P Dow Jones Indices, *Overview* (last visited December 20, 2021) (download "S&P 500 (USD) Factsheet" from Documents dropdown menu); [29] *1980 Revisited*, Forbes (March 6, 2000); *see also* IEEFA update: Oil and gas stocks place dead last in 2019, again, despite 30% price rise (January 9, 2020)

[49] *See, e.g.*, Jeremy Grantham, *The Mythical Peril of Divesting from Fossil Fuels*, Grantham Research Inst. on Climate Change and the Env't (June 13, 2018) (arguing that divesting from any single sector produces immaterial results, and noting in particular that "Investors with long-term horizons should avoid oil and chemical stocks on investment grounds. They face a sustained headwind. In contrast, investing in companies that benefit from decarbonising the economy, although they come with no guarantee of success, do offer a sustained tailwind; their top-line revenues

2) Duty of Impartiality

Pension fund trustees have a fiduciary duty as well as an obligation under private trust law to act solely and impartially in the interest of all the fund's members and beneficiaries.[50] The Board must be "impartial with respect to the various beneficiaries" of the pension fund and "so account for principal and income, that the trust estate will produce income that is reasonably appropriate to the purposes of the trust and to the *diverse present and future interests of its beneficiaries.*"[51] The Board's duty to future beneficiaries (members) also requires that it avoid providing "higher-than-appropriate yield for the current income beneficiary"[52] by taking undue short-term risks. Instead, the Board must "administer the system to create and maintain long-term stability and viability in the system."[53]

Remaining invested in the fossil fuel industry directly privileges current beneficiaries over future beneficiaries because it does not represent a pursuit of long-term value creation. The likelihood of a low-carbon transition threatens the long-term value of fossil fuel companies, and therefore of any fund that continues to be invested in the sector.[54]

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will certainly be growing faster than the rest of the economy. Ethical arguments for divestments are simply not necessary. They are a pure bonus.")

[50] Since there are no statutory provisions creating alternative duties or expressly providing otherwise, the common law duty of impartiality applies. *See* Restatement (Third) of Trusts § 4, cmt. (g) ("Some forms of trusts that are created by statute, especially public retirement systems or pension funds . . . are administered as express trusts, the terms of which are either set forth in the statute *or are supplied by the default rules of general trust law*.") (emphasis added); O'Neal v. Stanislaus County Employees' Retirement Assn., 8 Cal.App.5th 1184, 1207 (2017) ("[C]onsistent throughout the relevant case law ... is that the designation of retirement funds as trust funds and the express recognition of fiduciary duties related to management of those funds adds weight to the authority of the common law and statutory doctrines concerning actions taken by those overseeing trust funds . . ."); In re Est. of Stralem, 695 N.Y.S.2d 274, 278 (Sur. 1999) ("The primary duties of ordinary care, diligence and prudence and of absolute impartiality among the several beneficiaries are of the very essence of a trust, and any impairment of these or similar obligations of a fiduciary are contrary to public policy.") (internal citations omitted)

[51] Restatement (Third) of Trusts § 79 (2007) (emphasis added). See also N.Y. Est. Powers & Trusts Law § 11-2.1 ("A trust shall be administered with due regard to the respective interests of income beneficiaries and remaindermen."); Merer by Merer v. Romoff, 660 N.Y.S.2d 241, 245 (Sup. Ct. 1997) (applying EPTL duty of impartiality); James Hawley, Keith Johnson, and Edward Waitzer, *Reclaiming Fiduciary Duty Balance*, 4 Rotman International Journal of Pension Management 2 (September 2011) ("Fiduciaries must ensure that their decision-making processes balance allocation of capital between near-term needs and future wealth creation and consider the potential transfer of risks between participant generations. Intergenerational wealth maximization requires active consideration of a range of factors beyond narrow financial criteria." The article also notes in Figure 1 that when prudence and loyalty (including impartiality) conflict, courts tend to resolve it in favor of the latter.)

[52] Restatement (Third) of Trusts § 79, cmt. (g)(1)

[53] White v. Pub. Emps. Ret. Bd., 268 P.3d 600, 607 (Or. 2011)

[54] *See, e.g.,* Bevis Longstreth, *Outline of Possible Interpretative Release by States' Attorneys General Under The Uniform Prudent Management of Institutional Funds Act*, InsideClimate News (January 26, 2016), ("The risks and rewards now offered by [fossil fuel-linked] securities are asymmetric, in the sense that the foreseeable rewards are not likely to be equal to the foreseeable risks. The risk that, at some unknown and unknowable, yet highly likely, point in the future, markets will begin to adjust the equity price of fossil fuel company securities downward to reflect the swiftly changing future prospects of those companies, is as serious as it is immense. Moreover, the possibility of that adjustment being a swift one is also a serious risk. A decision to linger in an investment with such an overhanging risk, and expect to time one's exit before the danger is recognized in the market, is a strategy hard to fit within the concept of prudence.")

Remaining invested in the fossil fuel industry also indirectly privileges the interests of older, white male beneficiaries over those of fund beneficiaries who are younger, female, Indigenous, or otherwise from racially diverse backgrounds. Delaying the low-carbon transition prolongs reliance on climate change-driving industries like the fossil fuel sector, which disproportionately affects people of color, low-income communities and Indigenous communities due to their proximity to impacts of fossil fuel extraction, refining and transport as well as exposure to the intensifying effects of climate change.

Importance of Disclosure

Knowledge of a state pension fund's exposure to climate risk, most notably its investments in fossil fuels, is critical in assessing the trustee's fulfillment of its fiduciary duties. The disclosure of such information must address both public and private equity investments, especially given the important role of private equity in funding the fossil fuel industry.[55] The disclosure must contain sufficient information to enable both beneficiaries and those with oversight responsibilities to evaluate the pension fund's management of climate risk and the portfolio's exposure to risk. This is consistent with stronger demand for climate risk disclosure, as evidenced by the 3000 institutions that have endorsed the Recommendations of the Task Force on Climate-Related Financial Disclosures to disclose information on their exposure to and management of climate-related financial risk.[56] Climate-risk disclosure will also be made more feasible with the recently announced SEC climate disclosure rules.

Limits of Engagement

While the fossil fuel industry touts its net zero by 2050 plans and investments in a clean energy transition, the reality shows that there is very little willingness by, for example the big oil, gas and coal companies ("Carbon Majors"), to shift away from its business as usual focus on fossil fuels. The limits of engagement have been illustrated by the Climate Action 100+ initiative, which is backed by 700 institutional investors with $68 trillion in assets. After several years of engagement, less than 12% of their 166 focus companies currently have adequate short-term emissions reduction targets or decarbonisation strategies, while none have aligned their capital expenditure with a 1.5ºC future or produced financial statements that reflect relevant climate risks.[57] These companies account for up to 80 percent of corporate industrial greenhouse gas emissions.[58]

As importantly, there is compelling evidence to show that efforts by CalPERS and CalSTRS to "engage" with fossil fuel companies, particularly through proxy voting, have not yielded any meaningful changes by the companies, and therefore have failed to address the exposure of these companies to climate-related financial risk.[59] In particular, CalPERS and CalSTRS have recently voted against climate resolutions at major fossil fuel corporations BP, Occidental Petroleum, Equinor, Woodside Petroleum, and Shell.[60] Moreover, CalPERS' role as the Climate Action 100+ engagement lead for ExxonMobil,[61] and CalPERS' and

[55] *Private Equity Funds, Sensing Profit in Tumult, Are Propping Up Oil*, The New York Times (October 13, 2021)
[56] Task Force on Climate-related Financial Disclosures, *TCFD Supporters around the world* (accessed March 14, 2022)
[57] Alex Wilks, The Sunrise Project, *Benchmarks show company climate inaction: why haven't CA100+ investors achieved more?* (March 30, 2022)
[58] Climate Action 100+, *Companies* (accessed April 7, 2022)
[59] Fossil Free California, *California Pensions Fail to Engage: A review of CalPERS' and CalSTRS' votes against shareholder climate resolutions* (June 8, 2022)
[60] *See* Glass Lewis, Global Proxy Voting Decisions: CalPERS, https://viewpoint.glasslewis.com/WD/?siteId=CalPERS; Glass Lewis, Global Proxy Voting Decisions: CalSTRS, https://viewpoint.glasslewis.com/WD/?siteId=CalSTRS.
[61] Responsible Investor, *RI's list of lead and supporting investors at the initiative's focus companies* (January 21, 2022)

CalSTRS' support for electing three "climate-friendly" ExxonMobil Board members has not tamed the fossil fuel expansion plans by the Oil Major.[62]

We therefore caution against a state pension fund relying on engagement with fossil fuel companies as a way to satisfy its fiduciary duties. Academic research has found no evidence to date that engagement (without divestment) has pushed fossil fuel companies to reduce their own transition and physical risks.[63] A policy of unquestioning shareholder engagement also presents a significant fiduciary danger, as it requires continued exposure to an industry that faces dire long-term risk. By comparison, recognition of the inadequacy of shareholder engagement with fossil fuel companies was a major factor in the New York State's divestment decisions.[64]

Pension Fund Exposure and Compliance with State Laws

CalPERS and CalSTRS currently have high exposure to the fossil fuel industry. As of 2021, CalPERS had $5.5 billion invested in fossil fuel producers alone out of a total of $27 billion in the broader fossil fuel industry, while CalSTRS invested $3.4 billion in fossil fuel producers out of nearly $16 billion in broader fossil fuel investments.[65] This includes a total of $1.5 billion and $1 billion, respectively, invested in the three Oil Majors - Exxon, Chevron, and Shell.[66] In light of the risks outlined above, such high levels of financial exposure to the fossil fuel industry are at odds with the principles of prudence and long-term value creation that should guide trustees' management of the pension funds, and therefore may violate their fiduciary obligations.

The constitution of California empowers the legislature to prohibit retirement systems from making some investments when such a prohibition is in the public interest.[67] In the case of fossil fuel divestment, the public interest, fiscal health of the state, and security of public employees retirements are all aligned. As stewards of the public interest, we believe support for this bill falls squarely within this mandate.

For the reasons set forth above, we urge Committee members to support The Fossil Fuel Divestment Act (SB 1173) to require your state pension funds to develop and implement a comprehensive and transparent plan to divest from fossil fuels.

Sincerely,

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[62] Oil Change International, *Big Oil Reality Check — Updated Assessment of Oil and Gas Company Climate PlansBig Oil Reality Check* (May 24, 2022)

[63] *See, e.g.*, Ellen Quigley, Emily Bugden, and Anthony Odgers, *Divestment: Advantages and Disadvantages for the University of Cambridge* 110 (2021), https://ssrn.com/abstract=3849513 ("By any threshold one could devise as to the efficacy of a tactic for action on climate change and other social and environmental issues, it would be difficult to deem shareholder engagement a success.")

[64] *See, e.g.*, Anne Barnard, *New York's $226 Billion Pension Fund Is Dropping Fossil Fuel Stocks* (2021) ("But Mr. DiNapoli, who also long advocated for engagement over divestment, said a turning point for him came with what he called ExxonMobil's "disappointing, frustrating" rebuffs in recent years to the New York State fund, California's teachers' pension fund and other shareholders that have pushed for a more environmentally sustainable business plan.")

[65] Climate Safe Pensions & Stand.Earth, *The Quiet Culprit: Pension Funds Bankrolling the Climate Crisis* (December 2021)

[66] Id.

[67] Cal. Const., art. XVI, § 17 (g) ("The Legislature may by statute continue to prohibit certain investments by a retirement board where it is in the public interest to do so, and provided that the prohibition satisfies the standards of fiduciary care and loyalty required of a retirement board pursuant to this section.")

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